How to walk the fiscal tightrope that lies before us

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FT.com / Columnists / Martin Wolf - How to walk the fiscal tightrope that lies before us.

Martin Wolf takes Niall Ferguson to the slaughterhouse, and guts him well and truly:

Prof Ferguson believes instead in a conservative free lunch. This is the view that fiscal tightening today would have little effect on activity. Normally, when monetary policy has room for manoeuvre and the private sector's borrowing is unconstrained, that is right. But, as Olivier Blanchard, chief economist of the International Monetary Fund, and colleagues note in a recent report: "To the extent that monetary policy, including credit and quantitative easing, had largely reached its limits, policymakers had little choice but to rely on fiscal policy."If these governments had decided to balance their budgets, as many conservatives demand, two possible outcomes can be envisaged: the plausible one is that we would now be in the Great Depression redux; the fanciful one is that, despite huge increases in taxation or vast cuts in spending, the private sector would have borrowed and spent as if no crisis at all had happened. In other words, a massive fiscal tightening would actually expand the economy. This is to believe in magic.

As Wolf concludes:

So, yes, high-income countries face huge fiscal challenges. And yes, the crisis-hit countries start from grossly unsustainable fiscal positions. But the US is not Greece. Moreover, a massive fiscal tightening today would be a grave error. There is a huge risk — in my view, a certainty — that this would tip much of the world back into recession. The private sector must heal. That, not fiscal retrenchment, is the priority.

Quite so.